CARE's Productivity Estimates Are Grossly Exaggerated -- CARE Again Claims the Sky Is Falling

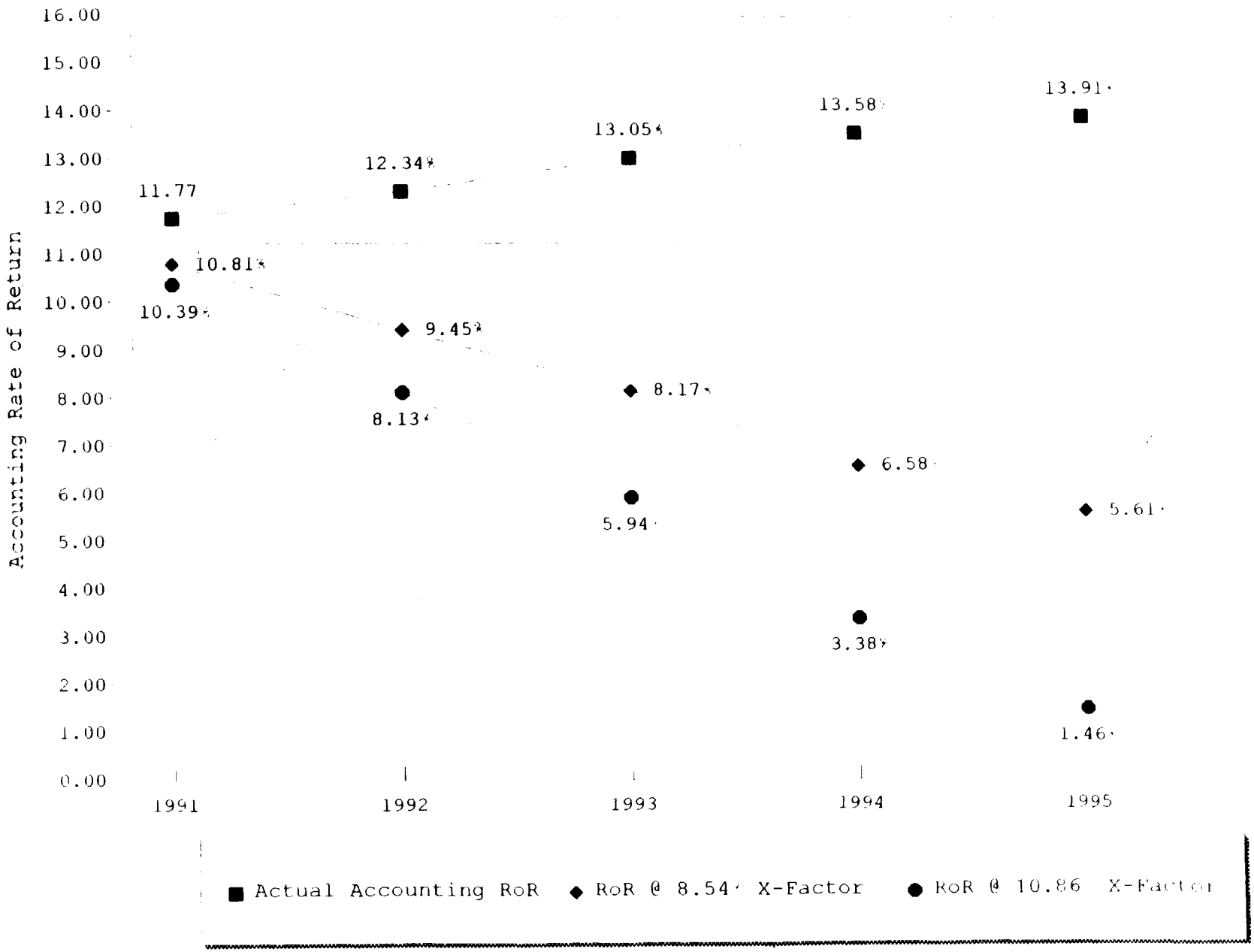
- CARE members incorrectly estimate LEC productivity to be between 8.54% and 10.86%.

- CARE stated that access prices would rise $500M in the 1996 annual filing.

  - Price cap LEC access prices went up only $14M. This amount included an $89M price increase by Sprint. Absent Sprint, LEC access prices fell by $75M.

- CARE members' productivity estimates completely ignore common sense.

Interstate Accounting RoRs for Price Cap LECs



What Would Be Required for a LEC to Keep Pace with a 10% X-Factor

- In order to keep pace with a 10% X-Factor in today's environment, a LEC would have to:

  - generate 18% minute growth each year, nearly three times the current rate. Total LEC minute demand would have to double in absolute levels every four years;

  or

  - cut all employment levels, all employee-related expenses, all-retiree-related expense and all expenses not directly associated with capital recovery and plant maintenance by 12% every year. LECs would have about one-half of the current employment and non-capital expense levels in five years [reductions of 235,000 in employees and $12.5 billion in expenses].

- It will be difficult for incumbent LECs to maintain existing demand levels and impossible to generate the kind of demand growth implied above -- given current market conditions and especially given the effects of competition and the implementation of the Telecommunications Act of 1996.

Moreover, the Recent Accounting Analyses Are Fundamentally Flawed

- MCI, CARE, and Ad Hoc filed an analysis of the 1995 annual filing that purports to show LECs would have to anticipate at least 8.54% productivity to elect the no-sharing option.

  - This flawed analysis assumes LECs started from a hypothetical 1994 11.25% rate of return, rather than the actual 13.78%.
    - LEC earnings did not average nor should have been expected to average 11.25% after five years of price cap regulation.
    - Those LECs earning near 11.25% did not elect the no-sharing option.

  - CARE also incorrectly assumes a composite tax rate of 34%. LECs average approximately 40%.

  - When CARE's pseudo-analysis is run using the facts at the time the LEC elections were made, it shows that LECs' accounting productivity would only need to be 2.85% to elect the no-sharing option in the 1995 annual filing.

  - An analogy to what CARE is doing would be taking a 10 second time from a 100 meter dash and saying that LECs can run a 500 meter race in the same 10 second time. This is impossible even for Carl Lewis.

Analysis of MCI's Figure 1

Starting Rate of Return:	(RoR)	13.78%
Price Cap Revenue, 000:	(Rev)	21,618,490
Net Investment, 000:	(Inv)	30,828,507
Composite Income Tax Rate:	(TaxRate)	40.00%

50/50 Sharing @	N/A	12.25%	12.25%	N/A
100 Sharing @	N/A	13.25%	16.25%	N/A

Acctg RoR Prod	X-FACTOR (X) 4.0%	4.0%	4.7%	5.3%
-2.14%	11.20%	11.20%	10.90%	10.65%
-0.95%	11.70%	11.70%	11.40%	11.15%
-0.71%	11.80%	11.80%	11.50%	11.25%
0.24%	12.20%	12.20%	11.90%	11.65%
1.43%	12.70%	12.47%	12.33%	12.15%
2.61%	13.20%	12.72%	12.58%	12.65%
2.85%	**13.30%**	**12.75%**	**12.63%**	**12.75%**
3.80%	13.70%	12.75%	12.83%	13.15%
4.99%	14.20%	12.75%	13.08%	13.65%
6.18%	14.70%	12.75%	13.33%	14.15%
7.37%	15.20%	12.75%	13.58%	14.65%
8.56%	15.70%	12.75%	13.83%	15.15%
9.74%	16.20%	12.75%	14.08%	15.65%
10.93%	16.70%	12.75%	14.25%	16.15%
12.12%	17.20%	12.75%	14.25%	16.65%

MCI's Formula: AdjRoR = RoR+[Rev*(1-TaxRate)*(Prod-X)]/Inv

Source for Original Analysis: MCI Reply Comments, CC Docket No. 94-1, 4th FNPRM, Filed March 1, 1996.

Moreover, the Recent Accounting Analyses Are Fundamentally Flawed (Cont'd.)

- Ad Hoc also uses this same flawed method to analyze the 1994 annual filing, in which most LECs elected the lowest X-factor, 3.3%.

  - Ad Hoc claims that its analysis shows that LEC productivity is no greater than 7.45%. Curiously, this ceiling is lower than the 8.54% floor calculated by Ad Hoc.

- Ad Hoc adds an add-back adjustment to the break-even rate of return to arrive at a contrived productivity ceiling of 10.86%, slightly higher than Ad Hoc's advocated X-factor of 10.3%.

  - It is a ludicrous implication that add-back raises LEC productivity. Add-back simply raises the starting rate of return thereby reducing the level of productivity a LEC would have to achieve to elect the no-sharing option over the 12.75% Rate of Return option.

- When Ad Hoc's further accounting analysis is run using the facts at the time the LEC elections were made, it shows that LEC accounting productivity is no greater 3.47%.

- Thus, using the facts, this analysis of MCI, CARE and Ad Hoc concludes that LEC accounting productivity is between 2.85% and 3.47%.

Analysis of Ad Hoc's Figure 2

Starting Rate of Return:	(RoR)	13.03%
Price Cap Revenue, 000:	(Rev)	21,618,490
Net Investment, 000:	(Inv)	30,828,507
Composite Income Tax Rate:	(TaxRate)	40.00%

50/50 Sharing @	N/A	0.1225	0.1325
100 Sharing @	N/A	0.1625	0.1725

Acctg RoR Prod	X-FACTOR (X) 3.3%	3.3%	4.3%
-0.93%	11.25%	11.25%	10.83%
0.26%	11.75%	11.75%	11.33%
1.45%	12.25%	12.25%	11.83%
2.04%	12.50%	12.38%	12.08%
3.47%	**13.10%**	**12.68%**	**12.68%**
3.82%	13.25%	12.75%	12.83%
5.01%	13.75%	13.00%	13.29%
6.20%	14.25%	13.25%	13.54%
7.39%	14.75%	13.50%	13.79%
8.58%	15.25%	13.75%	14.04%
9.76%	15.75%	14.00%	14.29%
10.95%	16.25%	14.25%	14.54%
11.67%	16.55%	14.25%	14.69%
12.14%	16.75%	14.25%	14.79%
13.33%	17.25%	14.25%	15.04%

Formula Used By Ad Hoc: AdjRoR = RoR+[Rev*(1-TaxRate)*(Prod-X)]/Inv

Source for Original Analysis: Ad Hoc Ex-Parte in CC Docket No. 94-1, 4th FNPRM, Filed April 9, 1996.

The FCC's Own Accounting Analyses, the Frentrup-Uretsky and Bush-Uretsky Studies, Conclude That LEC Accounting Productivity Is No Greater than 5.0%

- This occurred during a period which saw the rapid decline in interest rates and faster interstate demand growth as a result of historical shifts from interstate to state and other historical anomalies.

- These events were unique and cannot be expected to occur again in the near future.

The Commission Should Regulate Prices, Not Earnings. It Should Not Regulate Both.

- Greater economic efficiencies would be realized if only prices were regulated.

- LEC earnings are below those of IXCs and other firms when compared on a consistent basis.

- A self-correcting method that is economically meaningful is needed.

General Criteria for an X-Factor

- Must be economically meaningful.
- Should pass future LEC unit cost reductions through to consumers.
- Should be simply calculated and based on accessible and verifiable data.

The Record Shows:

- TFP is the most economically sound measure of LEC productivity.
- All parties agree that TFP is around 3.0%.

Adjustments Proposed by Ad Hoc, AT&T and/or Sprint

- CARE uses accounting earnings to justify uneconomic adjustments to the TFP:

  - Input Price
  - Interstate
  - Hedonics
  - CCL
  - CPD

Accounting Earnings Are Not Economic Measures of Productivity -- They Are Arbitrary

ATTACHMENT 8

USTA
MARKET-BASED APPROACH
TO ACCESS REFORM

USTA COMMENTS
CC DOCKET NO. 96-262
JANUARY 29, 1997

USTA MARKET-BASED APPROACH TO ACCESS REFORM

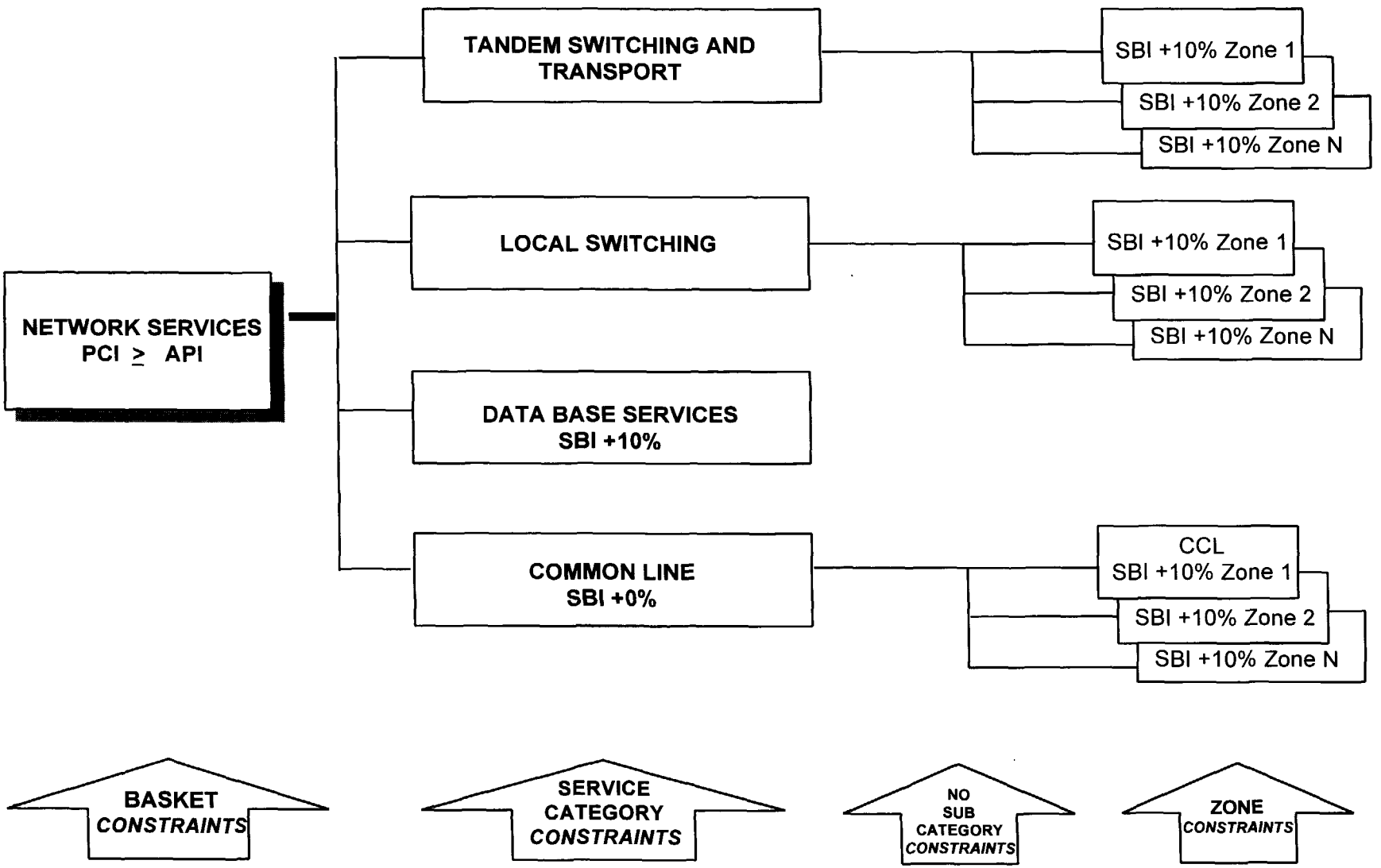
	Phase I (Reduced regulation and Increased pricing flexibility)		Phase II (Out of price caps)		Forbearance	
Services	**Trigger**	**Regulatory Reform**	**Trigger**	**Regulatory Reform**	**Trigger**	**Regulatory Reform**
Switched Access	Interconnection Agreement or Effective SGAT	Replace Part 69 for PC LECs with new Part XX, Pricing Flexibility, Vol. and Term, Contract Tariffs, Simplified Basket Structure	Interconnection Agreement or effective SGAT **with use** or facilities based provider	Streamlined regulations and removal from price caps	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance
Tandem Switching and Transport	Interconnection Agreement or Effective SGAT	Replace Part 69 for PC LECs with new Part XX, Pricing Flexibility, Vol. and Term, Contract Tariffs, Simplified Basket Structure	Interconnection Agreement or effective SGAT **with use** or facilities based provider	Streamlined regulations and removal from price caps	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance
Database	Interconnection Agreement or Effective SGAT	Replace Part 69 for PC LECs with new Part XX, Pricing Flexibility, Vol. and Term, Contract Tariffs, Simplified Basket Structure	Interconnection Agreement or effective SGAT **with use** or facilities based provider	Streamlined regulations and removal from price caps	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance
Special Access and Collocated Direct Trunked Transport	NA	NA	NA	NA	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance
Directory Assistance	NA	NA	NA	NA	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance
Interexchange Basket	NA	NA	NA	NA	Satisfy Section 10(a) of the Act - just & reasonable rates - consumer protection - in public interest	Forbearance

ATTACHMENT 9

USTA
PROPOSED LEC PRICE CAP STRUCTURE

USTA COMMENTS
CC DOCKET NO. 96-262
JANUARY 29, 1997

PROPOSED LEC PRICE CAP STRUCTURE



ATTACHMENT 10

USTA
TIC COMPONENTS

USTA Comments
CC Docket No. 96-262
January 29, 1997

TIC COMPONENTS

- 80% OF TANDEM REVENUE REQUIREMENT
- CCS/STP COSTS ALLOCATED TO TANDEM SWITCHING
- HOST/REMOTE CONFIGURATIONS
- CENTRAL OFFICE TERMINATION COUNTS
- COE MAINTENANCE MISALLOCATIONS
- ANALOG END OFFICE TRUNK SWITCH PORTS
- REDEFINED TANDEM SWITCHED TRANSPORT
- OTHER AREAS UNDER INVESTIGATION

80% OF TANDEM SWITCHING COST

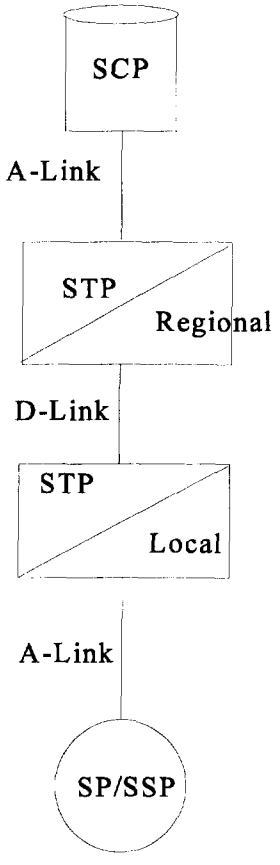
The FCC in REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING, CC Docket No. 91-213, issued October 16, 1992, paragraph 25, indicated "in order to ease the impact of a rate structure change on small IXCs, however, we prescribe that the tandem element initially recover only twenty percent of the current tandem revenue requirement, with the remainder of the revenue requirement recovered through the interconnection charge, and find that such a rate is just and reasonable."

COMMON CHANNEL SIGNALING

As accurately outlined in FCC 96-325 (para. 455), "Signaling systems facilitate the routing of calls between switches." The major components of the signaling system are:

1. Service Switching Point (SSP)
2. Signaling Transfer Point (STP)
3. Service Control Point (SCP)
4. Signaling Links

The FCC ordered that eighty percent of the tandem switching category be recovered in the Interconnection Charge. Consequently, it is the portion of the signaling network that is categorized to the tandem that is recovered by the interconnection charge. Typically, this consists of the STPs. The costs of the SCPs are recovered by LIDB, 800 and other data base charges. The SSPs are categorized to Local Switching (3AO). The associated signaling links, while not categorized as tandem, are assigned by Part 69 rules to the transport category.



Common Channel Signaling

3152D-Service Control Point (SCP)/Integrated Service Control Point (ISCP) associated with Common Channel Signaling

800/LIDB
and other Data Base Charges
Recover SCPs

Tandem Switching
3152Z-Signal Transfer Point (STP) Digital Switching for services such as 800 Service

7502Z-Processor that functions exclusively with a Signal Transfer Point

315BO-SS7 equipment at a through switched
Class 4/5 end office
(Split between 3A0 and 2A1)

Local Switching

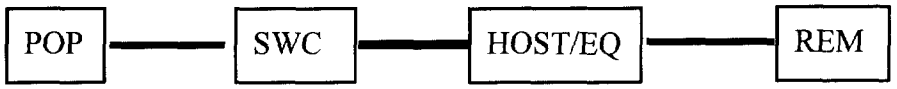
315AO-Signaling System 7 equipment at a Class 5 end office

HOST/REMOTE CONFIGURATIONS

The under recovery of host/remote configurations is similar to the under recovery of tandem switching costs -- only a portion of the host/remote revenue requirement is recovered through the tandem fixed and per mile rates. The difference is included in the TIC.

For service to a remote switch, tandem fixed and per mile/per MOU charges apply for use of the facilities from the host to the remote. This structure was ordered by the FCC in its July 23, 1993 First Memorandum Opinion and Order on Reconsideration.[1] The tandem fixed and per mile elements apply to host/remote configurations for both tandem-routed and direct trunk transport customers. The following diagrams illustrate the rating of local transport host/remote configurations:

Dedicated to End Office



↑EF ↑DTT ↑ TIC ↑ Tan fixed/MOU
↑ Tan per mile/MOU

Common to Access Tandem

↑EF ↑ Tan fixed/MOU ↑TIC ↑Tan fixed/MOU
Tan per mile/MOU ↑Tan per mile/MOU

Dedicated to Tandem

↑EF ↑ DTT ↑ Tan fixed/MOU ↑TIC ↑Tan fixed/MOU
Tan per mile/MOU ↑Tan per mile/MOU
Tan switching

[1] Transport Rate Structure and Pricing. First Memorandum Opinion and Order on Reconsideration, CC Docket No. 91-213, 8 FCC Red 5370 (July 21, 1993) at 10-14.

HOST/REMOTE CONFIGURATIONS (continued)

In Parts 36 and 69 host/remote circuit equipment and cable and wire facilities (C&WF) have their own categories, and are therefore easily identified for revenue requirement purposes.

Part 36.126(f)(1) - Host/Remote Message Circuit Equipment-Category 4.3 states that host/remote message circuit equipment includes message host/remote location circuit equipment for which a message circuit switching function is performed at the host central office associated with cable and wire facilities as described in 36.152(c).

Part 36.126(f)(1)(I) states that the category 4.3 costs of host/remote circuit equipment assigned to message services for the study area is apportioned among the exchanges, interstate toll, and interstate toll operations on the basis of the assignment of host/remote message cable and wire facilities as described in 36.157.

Part 36.157 - Host/Remote Message C&WF-Category 4 states that the cost of host/remote message C&WF excluding WATS closed end access lines for the study area is apportioned on the basis of the relative number of study area minutes-of-use kilometers applicable to such facilities.

Part 69.305(b) (C&WF) and 69.306(c) (circuit equipment) assign host/remote message investment to transport.

CENTRAL OFFICE TERMINATION COUNTS

Part 36.126 requires that interexchange trunk investment is assigned to Message Joint, Interstate PL and Intrastate PL and allocated based on termination counts.

In the course of developing the basic studies of central office circuit equipment, it is possible to directly identify by category those costs associated with private line and message services. In this way, the circuit equipment study process develops specific jurisdictional costs associated with private line services and those message services that are not multi-jurisdictional in nature. However, section 36.126 (e)(3)(I) of Part 36 of the FCC Rules dictates that the costs of interexchange circuit equipment will be assigned to categories based on the average cost per termination. Within the interexchange circuit equipment costs, all categories except Message Joint are jurisdictional pure and could be directly assigned to jurisdictions if it were permitted by the Part 36 rules. For the Message Joint investment classification, traffic usage factors determine the final jurisdictional allocation. The distribution of costs to categories and jurisdictions based on direct identification will reduce the IC by reassigning costs to intrastate and interstate (Common Line, Local Switching and Special Access).

C.O. EQUIPMENT MAINTENANCE MISALLOCATION

Part 36.321 (a) states that expenses related to Central Office Equipment are summarized in the following accounts:

Central Office Switching Expense	Account 6210
Operator Systems Expense	Account 6220
Central Office Transmission Expense	Account 6230

Additionally Part 36.321 (b) states that the expenses in these accounts are apportioned among the operations on the basis of the separations of investments in Central Office Equipment (COE) Accounts 2210, 2220, and 2230, combined. By separating the expenses on the combined COE, a mismatch occurs to the extent the expenses associated with maintaining the investment are apportioned differently than the investment being maintained. A more cost causative approach is to separate the central office expenses based on the separation of the investment.

This proposal would modify Part 36.321 (b) as follows -- Expenses in these accounts are apportioned among the operations on the basis of the separations of investment in the related asset account:

Expense Account	Asset Account
6210--Central Office Switching	2210--Central Office Switching
6220--Operator Systems	2220--Operator Systems
6230--Central Office Transmission	2230--Central Office Transmission

Consistent with the above modifications of Part 69, Subpart E, Apportionment of Expenses is in order. Part 69.401 (b) states that COE Switching, COE Operator Systems and COE Transmission (Accounts 6210, 6220 and 6230) shall be apportioned among the interexchange category and access elements on the basis of the apportionment of the total COE investment. This results in a portion of COE maintenance expense for local and operator switches being allocated to Common Line, Transport and special Access, where there is no switch investment to maintain. This non specific approach to the assignment of these expenses, has resulted in a net over assignment of expenses to the TIC. A cost causative approach is to a assign these expenses to the TIC. A cost causative approach is to assign these expenses to the Part 69 elements based on the specific assets being maintained.

C.O. EQUIPMENT MAINTENANCE MISALLOCATION (continued)

COE Switching Expenses Account 6210

COE Switching expenses are being incurred to maintain two categories of equipment, the local dial switch and the tandem switch. Under existing rules these costs are assigned to Common Line, Local Switching, Local Transport, Information, Private Line and Interexchange elements. The cost causative approach is to assign these expenses to the Part 69 elements based on the equipment being maintained. Therefore, COE Switching expenses should be assigned to the Transport element based on a relationship of interstate tandem switching investment assigned to the Transport element to total Part 69 interstate Switching investment. The remainder of the expenses in this category would be assigned to the Local Switching element.

COE Operator Expenses Account 6220

COE Operator expenses are being incurred to maintain operator equipment. This equipment is assigned to two elements in Part 69, Information and Interexchange. In some companies a third element, Operator Transfer, has been established. Under existing rules these expenses are assigned to Common Line, Local Switching, Local Transport, Information, Private Line and Interexchange elements. The cost causative approach is to assign these expenses to the Part 69 elements based on the equipment being maintained. Therefore, COE Operating expenses would be assigned to the Information, Interexchange and Operator Transfer elements based on the relative relationships established from the assignment of the Operator investment to these elements.

COE Transmission Expenses Account 6230

COE Transmission expenses are being incurred to maintain equipment found in most of the existing Part 69 elements except Billing and Collection. Rather that using the existing composite, the cost causative approach is to assign these expenses to the Part 69 elements based on the equipment being maintained. Like the other categories, COE Transmission expenses would be assigned to the Part 69 elements based on the relative relationships established from the assignment of Transmission investment to the Part 69 elements.

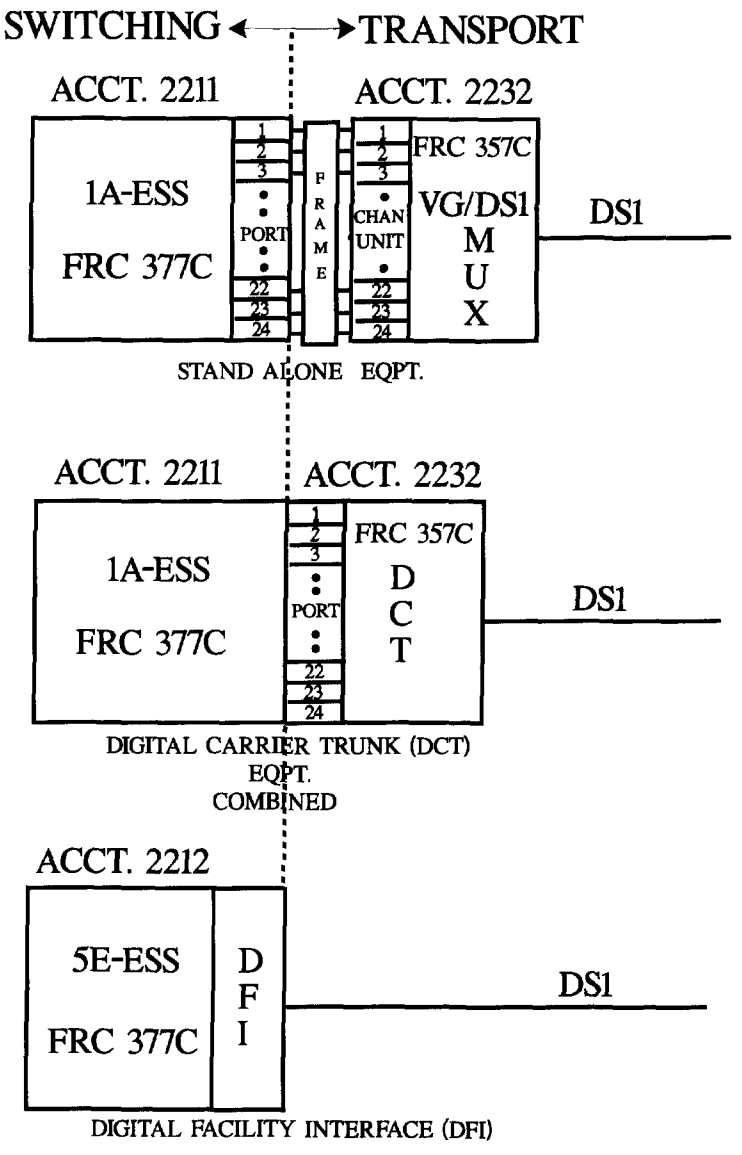
By using the above approach, costs will be removed from the Common Line, Access and Transport elements and will be reassigned to the Switching element.

ANALOG END OFFICE TRUNK SWITCH PORTS

When a call is carried on a DS1 transport (Direct of Common) or higher facility from an IEC to the terminating local switch, the DS1 signal must be broken down into a form (DSO) that can be processed in the switch. This function can be performed through the use of a standard DS1/Voice Grade multiplexer and 24 analog trunk side ports or through the use of a Digital Carrier Unit (DCT). The DCT provides a lower cost alternative when 24 trunks (DSOs) interconnect the switch by combining the functionality of a DS1/Voice Grade multiplexer and 24 analog trunk port.

In the analog switching environment, such as with an 1AESS switch, the costs of performing this function have been primarily assigned to transport, (FRC 357C, USOA Acct. 2232). In a digital switching environment, as with the 5ESS and DMS switches, these costs are assigned to Local Switching (FRC 377C, USOA Acct. 2212).

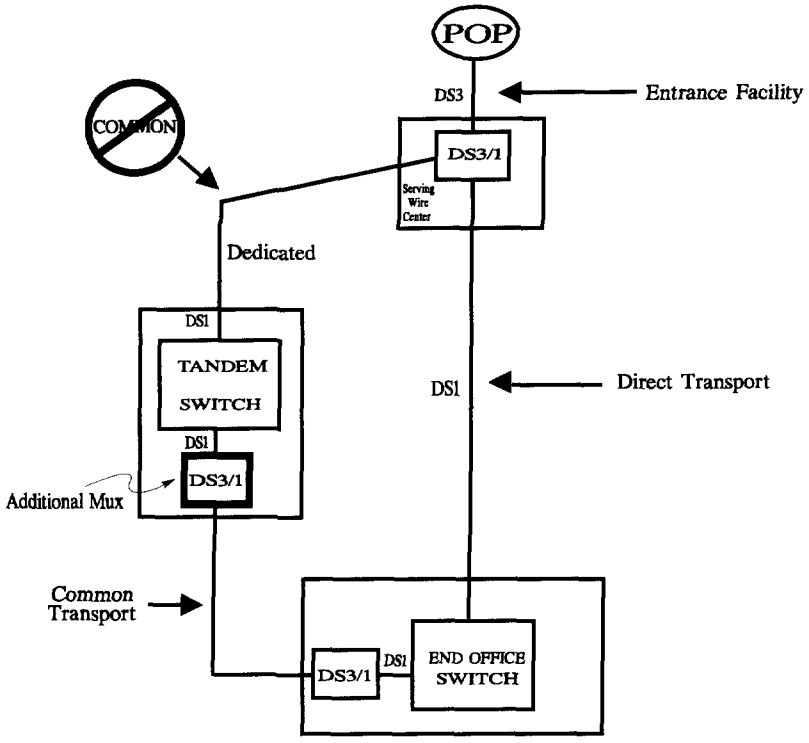
This function is one that is not required in the special access environment, so consequently, its costs are not reflected in the special access prices - and by extension, are not reflected in Local Transport prices. The analog switches account for approximately 25% of the RBOC lines in service (ARMIS 43-07).



REDEFINED TANDEM SWITCHED TRANSPORT

In the Report and Order in Docket 91-213, adopted in September of 1992, the Commission adopted an "interim" bundled per-minute rate structure for tandem-routed traffic, which encompassed the entire path needed to transport tandem-switched minutes between the POP SWC and the LEC EO. However, this path utilizes two different, and separate, types of facilities, which should be unbundled for rating purposes. The bundled structure, priced according to Commission rules, underestimates the costs of the tandem route and contributes to the TIC. The two parts of the tandem route were viewed individually to estimate the magnitude of TIC costs that are associated with the mandated bundled structure and pricing rules.

In the first part of the tandem route, between the POP SWC and the access tandem, facilities are actually dedicated, in the same manner as DTT, to each IXC. Since these are physically dedicated facilities, they should be priced in the same manner as DTT. Estimates of revenues associated with pricing the SWC-AT facilities at DTT rates, including rates based on airline miles between the SWC and AT, were developed for quantification.



In the second part of the tandem route, between the access tandem and the EO, "common" facilities are used that carry various types of traffic including interstate, state and local. This segment of the network should be priced on a per minute basis to reflect the mixed use nature of its traffic. However, the per minute rates ordered by the Commission should be modified in two ways. First, since the current TST per-minute fixed rate is based on one mix, as one is needed at the EO and one is needed at the tandem switch. Second, the use of 9000 mou per VGE in the TST rate development process overstates actual usage on the tandem route. Usage more representative of the actual should be incorporated in the rate development. Lastly, an adjustment may be made to account for a difference in air miles from the current bundled structure (using SWC-EO air miles for TST rating) and the unbundled structure (using per minute rates only for the portion between the AT and the EO). The difference in revenues between the current TST pricing structure and the unbundled structure described above are in the TIC.